1983

Wasatch Bank of Pleasant Grove, A Corporation v. Surety Insurance Company of California, a Corporation : Brief of Defendant-Respondent

IN THE SUPREME COURT

STATE OF UTAH

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WASATCH BANK OF PLEASANT GROVE, a corporation,

Plaintiff-Appellant,

vs. Case No. 19158

SURETY INSURANCE COMPANY OF CALIFORNIA, a corporation,

Defendant-Respondent.

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BRIEF OF DEFENDANT-RESPONDENT

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APPEAL FROM A SUMMARY JUDGMENT OF THE FOURTH JUDICIAL DISTRICT COURT OF UTAH COUNTY, STATE OF UTAH, HONORABLE DAVID SAM JUDGE

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Annot., Money loaned or advanced to contractor as within coverage of bond of building or construction contractor, 127 A.L.R. 974 (1940) Supp. 164 A.L.R. 783 .....

SUPREME COURT OF UTAH

STATE OF UTAH

WASATCH BANK OF PLEASANT GROVE a corporation,	:	
Plaintiff and Appellant,	:	
vs.	:	No. 19158
SURETY INSURANCE COMPANY OF CALIFORNIA, a corporation,	:	
Defendant and Respondent.	:	

BRIEF OF RESPONDENT

NATURE OF CASE

This is an action by plaintiff-appellant to recover under a Bond executed by defendant-respondent and a contractor. Plaintiff-appellant seeks to recover from defendant-respondent, surety on the Bond, sums which plaintiff-appellant advanced to the contractor's materialmen and laborers pursuant to agreement with the contractor.

DISPOSITION IN LOWER COURT

The Fourth Judicial District Court, the Honorable [illegible] Sam presiding, granted summary judgment in favor of defendant, cause of action. A copy of the Order of Summary Judgment attached to Appellant's Brief as Appendix A.

RELIEF SOUGHT ON APPEAL

The defendant-respondent requests this Court to affi the Order of the District Court dismissing this action w prejudice.

STATEMENT OF FACTS

Defendant-respondent accepts plaintiff-appellant' Statement of Facts as fairly describing the factual setting this case.

ARGUMENT

POINT I

UNDER THE CLEAR TERMS OF THE BOND, PLAINTIFF-APPELLANT HAS NO CAUSE OF ACTION.

The Subcontract Labor and Material Payment Bond ex cuted by Allan T. Munn, dba ATM Masonry Company, (ATM),

Surety Insurance Company of California, (SIC), bound them unto Valley Builders "for the use and benefit of claimants as hereinbelow defined". The Bond defined claimants as follows:

> "A claimant is defined as one having a direct contract with the Principal for labor, material, or both, used or reasonably required for use in the performance of the contract, labor and material being construed to include that part of water, gas, power, light, heat, oil, gasoline, telephone service or rental of equipment directly applicable to the subcontract."

By the express terms of the Subcontract Labor and Material Payment Bond, Wasatch is excluded from coverage under the Bond. Wasatch is not "one having a direct contract with the Principal" for labor and material. Rather, Wasatch is a provider of funds to ATM, with which ATM discharged its obligation under the Bond to make prompt payment to laborers and materialmen. As the Kansas Court noted in Neodesha National Bank v. Russell, 200 P. 281 (Kans., 1921):

> The bank is not in the position of having furnished labor or material that went into the building. The provision requiring public officials to take the bond was to protect persons furnishing labor or material used in the construction of public buildings, not to protect

> money lenders advancing money to contractors in financing the work of construction." Id. at 282

Wasatch, therefore, being excluded from coverage under the Bo has no claim thereunder and no basis on which to maintain a ca of action.

POINT II

THE CLEAR WEIGHT OF AUTHORITY PRECLUDES WASATCH FROM MAINTAINING ITS CAUSE OF ACTION.

Despite the clear language of the Bond which plain precludes the claim of Wasatch against SIC, Wasatch nonetheles seeks to bring itself within the protection of the Bond under theory of equitable subrogation. This theory is asserted spite of the overwhelming weight of authority against it. T law on the subject is summarized in 17 Am.Jur.2d, Contractor Bonds, §§ 10 and 11 as follows:

> "Generally speaking, under the ordinary form of contractor's bond conditioned on the performance of the contract and the payment of all claims for labor and material, a lender of money to the contractor cannot recover the amount thereof from the surety, even though the borrowed money has been wholly applied to the payment of the cost of the labor

> and material actually used in the project. Moreover, under a bond conditioned on the satisfaction of all claims for labor, material, encumbrances, or otherwise, a surety is not liable for money loaned to the contractor expressly for paying the cost of labor and material. . . .
>
> It is quite uniformly held that even though money loaned to a building or construction contractor has been used in pay [sic] laborers or materialmen on the project, the lender is not thereby subrogated to the claims and rights of such laborers and materialmen against the contractor's bond."

The rule is re-stated in 127 A.L.R. 974 as follows:

> "The well-established general rule is that a claim for money loaned or advanced to a building or construction contractor is not within the coverage of the ordinary form of contractor's bond conditioned for the performance of the contract in the payment of all claims for labor and material, even though the borrowed money has been wholly applied to the payment of the cost of labor and material actually going into the construction project." Id. at 976. Supp. 164 A.L.R. 783.

Numerous cases support this general proposition of law. See, e.g., Nelson v. Hagen, 146 N.W.2d 876 (N.D., 1966), U.S. v. Western Contracting Corporation, 341 F.2d 383 (8 Cir., 1965), Bower v. Tebbs, 314 P.2d 731 (Mont., 1957), Vershchoyle v.

Holifield, 123 S.W.2d 878 (Tex.Comm.Ap., 1939), First Natio Bank of Chisholm v. O'Neil, 223 N.W. 298 (Minn., 1929), Paxton Spencer, 265 P. 751 (Utah, 1928), Neodesha National Bank Russell, 200 P. 281 (Kans., 1921), U.S. v. Rundle, 107 F. (9th Cir., 1901).

The Utah Supreme Court in Paxton, supra., recogniz this well-established rule and stated as follows:

> "To hold the surety liable for advancements made or money loaned to the contractors to enable them to carry out the contract without the assent of the surety, unless the facts are such that it would be inequitable to not hold a surety liable, is to read into the contract a liability not assumed by the surety and a liability clearly not contemplated by the parties at the date of the execution of the bond. The authorities seem to be quite uniform in holding that a surety is not liable for advancements or loans made under circumstances similar to those appearing in this record." Id. at 753.

See also U.S. v. Rundle, 107 F. 227 (9th Cir, 1901) ("[T]h protection afforded by the bond was to such only as might suppl the contractor with labor and materials in the prosecution of h work. It did not extend to a bank which might lend money for t purpose of paying for such work and materials.") By the cle terms of the Subcontract Labor and Material Payment Bond invo

in the instant case, its benefits extended only to those "having a direct contract with the Principal for labor, material, or both, used or reasonably required for use in the performance of the contract." It did not extend to those advancing funds to the principal to pay for labor and materials. This Court should not read into this Bond "a liability not assumed by the surety and a liability clearly not contemplated by the parties at the date of the execution of the bond" Paxton, supra., but should follow the overwhelming weight of authority and hold that Wasatch is not entitled to be subrogated to the rights of ATM's laborers and materialmen.

POINT III

BY EQUITABLE CONSIDERATIONS, WASATCH SHOULD BE DENIED EQUITABLE SUBROGATION.

In an effort to wriggle out of the obviously adverse implications of the firmly established general rule mentioned above, plaintiff-appellant seizes upon language in the Paxton case wherein the Utah Supreme Court stated that a surety is not liable for advances or loans made under circumstances such as those involved in the instant case "unless the facts are such that it would be inequitable to not hold the surety liable", Paxton v. Spencer, supra., at 753. Plaintiff-appellant argues

that this case comes within the above-stated exception. A rev of the facts of this case reveals the fallacy of plaintiff-appe lant's argument.

In extending the line of credit to ATM, as with a loan, Wasatch ran the risk that the money would not be repaid Hence, the bank expected to receive a fair return for the risk assumed and required security to protect the loan. There wa also the inherent risk, however, that the security would b inadequate to protect the full value of the loan. In the presen action, Wasatch, for consideration, agreed to provide ATM with line of credit to the extent of $50,000.00 and, as its sol security, took an assignment of the contract payments from Valle Builders. Wasatch thereby assumed the risk that the loan or part thereof would not be repaid, and further that the securit might prove inadequate. Finally, it assumed the risk that Valle Builders would not honor the assignment. Wasatch now, however would have SIC, with whom Wasatch had no contractual relation ship, assume the risk which only Wasatch had assumed. Under th Bond, SIC did not assume any such risk. The Bond provided merel "that if the Principal [ATM] shall promptly make payment to al claimants as hereinafter defined, for all labor and material use

or reasonably required for use in the performance of the subcontract, then this obligation shall be void." SIC assumed only the risk that the principal (ATM) would not pay materialmen and laborers. The fact is that ATM did indeed pay all materialmen and laborers. The effect of ATM's arranging with Wasatch for a line of credit with which to pay the materialmen and laborers was that ATM paid the materialmen and laborers. Under the terms of the Bond, it did not matter how ATM paid off the materialmen and laborers - - whether it paid directly from funds received from Valley Builders or whether it paid by arranging a line of credit - - the essential and operative fact was that ATM pay, and this it did. Had ATM not paid the materialmen and laborers, whether by way of a line of credit with Wasatch or otherwise, SIC would have been liable under the Bond, which is the risk it assumed. However, the materialmen and laborers were paid and SIC should not be required to assume a risk beyond the terms of its agreement with ATM.

POINT IV

THE VOLUNTEER RULE, AS PROPERLY UNDERSTOOD, APPLIES TO THIS CASE AND DENIES WASATCH'S CLAIM FOR EQUITABLE SUBROGATION.

The plaintiff-appellant acknowledges the overwhelming weight of authority in favor of the general rule stated above but argues that the original basis for the rule no longer exists and that the rule is inequitable. Plaintiff-appellant's argument is based on a criticism of the volunteer rule. However, plaintiff-appellant misconstrues the volunteer rule.

The cases cited above recognize that a volunteer is not, as plaintiff-appellant maintains, one who gratuitously advances money for the payment of materialmen and laborers. These cases recognize that a bank or other creditor may advance money under contract expecting a profit in return, but still is considered a volunteer as far as the doctrine of equitable subrogation is concerned. For example, in Verschoyle v. Holifield, 123 S.W.2d 878 (Tex. C.A., 1939), the Court in applying the volunteer rule to the facts before it, states as follows:

> "In the state of affairs existing at the time when [the creditor] came to [the contractor's] aid, [the creditor] was liable neither primarily nor secondarily to the laborers or materialmen who later were paid with the funds advanced by him. He was not a party to the original contracts for the construction of the road, nor was he a party to the subcontract. He was not a surety on either of the two bonds." 123 S.W.2d at 881

Another example is Neodesha National Bank v. Russell, 200 P. 281 (Kans., 1921). In this case a bank loaned money to a contractor of a public building to pay for labor and material used in the construction work and took the contractor's notes in return. The interest-bearing notes were not paid and the bank sued the bonding company to recover. Despite the fact that the bank did not gratuitously advance the money, but did so pursuant to interest-bearing notes, the Court held that by loaning the money to the contractor, the bank was not entitled to subrogation to the rights of materialmen and laborers. The Court stated:

> "The bank was a mere volunteer; was under no obligation to become involved in the matter of the erection of the school building, except the usual desire of a bank to make a profit by loaning its money on interest." 200 P. 281

As these cases demonstrate, Wasatch is a volunteer for purposes of the doctrine of equitable subrogation despite the fact that it did not advance money to ATM gratuitously. Therefore, the doctrine of equitable subrogation does not apply to this case and Wasatch has no claim against SIC.

POINT V

WASATCH IS NOT A THIRD-PARTY BENEFICIARY OF THE BOND AND HAS NO CAUSE OF ACTION UNDER IT.

Plaintiff-appellant argues that it is a third-party beneficiary of the Bond executed by ATM and SIC. The general rule regarding third-party beneficiary contracts is as follows:

> "As a general proposition, the determining factor as to the rights of a third party beneficiary is the intention of the parties who actually made the contract. The real test is said to be whether the contracting parties intended that a third person should receive a benefit which might be enforced in the courts. Thus, it is often stated that the contract must have been intended for the benefit of the third person in order to entitle him to enforce it.
>
> The question of whether a contract was intended for the benefit of a third person is generally regarded as one of construction of the contract." 17 Am.Jur.2d, Contracts, §304.

Furthermore, a contract relied upon as authorizing recovery by an alleged third-party beneficiary must be strictly construed in favor of the person against whom liability is asserted. See Dawson v. Eldredge, 372 P.2d 414 (Ida., 1962).

The terms of the Subcontract Labor and Material Payment Bond are clear. There is no mistaking who the intended beneficiaries are. The Bond is "for the use and benefit of claimants as hereinbelow defined." The Bond defines a claimant as:

> "One having a direct contract with the Principal for labor, material, or both, used or reasonably required for use in the performance of the contract." (Emphasis added)

No where in the language of the Bond or in the circumstances surrounding its execution is there any indication that the parties intended to benefit a lender who may advance money for the payment to materialmen and laborers. Thus, Wasatch is not a third-party beneficiary of the Bond and has no claim thereunder.

CONCLUSION

The terms of the Bond are clear. The Bond was intended to benefit those having a direct contract with the principal (ATM) for labor and material. It was not intended to benefit one such as Wasatch who advanced funds to allow ATM to pay laborers and materialmen. The Bond provided that if ATM promptly made payment to all materialmen and laborers, then the Bond obligation

would be void. By securing a line of credit through Wasatch, discharged its responsibility to make prompt payment to materialmen and laborers, thereby voiding the Bond obligation SIC. Wasatch, in advancing the funds to ATM, assumed a certa amount of risk, for which it was compensated. This Court shou not permit Wasatch to shift to SIC the burden of the risk assume by Wasatch and for which it expected compensation. The cle weight of authority is that a lender of money to a contracto cannot recover the amount thereof from a surety, even though t borrowed money has been wholly applied to the payment of the cos of the labor and material used in the project. This Court should, therefore, affirm the District Court's Order of Dismis sal.

Respectfully submitted this 15th day of Septembe 1983.

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CERTIFICATE OF MAILING

MAILED, postage prepaid, this 15th day of September, 1983, a true and correct copy of the foregoing Brief of Defendant-Respondent to:

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